85-1679

Supreme Court, U.S.
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No. _____

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1985

DONALD O. DALEY,

Petitioner,

versus

WALTER L. FRANK, et al.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

I. WHETHER THE BANKRUPTCY JUDGE IS REQUIRED TO GRANT THE PLAINTIFF A TRIAL DE NOVO TO DETERMINE THE DISCHARGEABILITY OR NON-DISCHARGEABILITY OF A DEBT.

II. WHETHER THE BANKRUPTCY JUDGE, AND THE DISTRICT COURT JUDGE WERE PRESENTED SUFFICIENT FACTS TO SUSTAIN THE JUDGMENT DISMISSING THE RESPONDENT'S COMPLAINT.

III. WHETHER THE FINDINGS OF FACT BY THE BANKRUPTCY JUDGE, AND THE DISTRICT COURT JUDGE ARE CLEARLY ERRONEOUS.

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[1] *Pursuant to the provisions of Rule 21.1(G), Rules of the Supreme Court of the United States, the following is a list of all parties to the proceeding: *Petitioner: Donald O. Daley. Respondents: Walter L. Frank* individually and as Trustee of the Walter L. Frank M.D., Ltd., Employees' Pension Plan, Joan H. Frank.

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioner pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in these proceedings on November 13, 1985. Petitioner is the Debtor in Chapter 7 proceedings filed voluntarily pursuant to the Bankruptcy Reform Act of 1978 (hereinafter referred to as the "Bankruptcy Code"). Respondents are creditors seeking a judgment objecting to the discharge of their debt.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit in In Re: Donald O. Daley, Debtor (Walter L. Frank et al., Plaintiffs v. Donald O. Daley et al., Defendants) is reported at 776 F.2d 834 (App. D, infra). The opinion and order of the United States Bankruptcy Court, and judgment were entered and filed on February 23, 1984 (App. A and B, infra). The opinion and order of the United States District Court for the District of Arizona was entered and filed on October 5, 1984 (App. C, infra).

JURISDICTION

The opinion of the United States Court of Appeals for the Ninth Circuit was entered on November 13, 1985. A Petition for Rehearing was denied on January 13, 1986 (App. E, *infra*). This petition for certiorari was timely filed. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1) (1982).

STATUTORY PROVISIONS INVOLVED

United States Code, Title 11:

§ 523. Exceptions to discharge.

(a) A discharge under section 727, 1141, or 1328(b) of this title does not discharge an individual debtor from any debt—

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

(B) use of a statement in writing—

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and

(iv) that the debtor caused to be made or published with intent to deceive; or

(C) for purposes of subparagraph (A) of this paragraph, consumer debts owed to a single creditor and aggregating more than $500 for "luxury goods or services" incurred by an individual debtor on or within forty days before the order for relief under this title, or cash advances aggregating more than $1,000 that are extensions of consumer credit under an open end credit plan

obtained by an individual debtor on or within twenty days before the order for relief under this title, are presumed to be nondischargeable; "luxury goods or services" do not include goods or services reasonably acquired for the support or maintenance of the debtor or a dependent of the debtor; an extension of consumer credit under an open end credit plan is to be defined for purposes of this subparagraph as it is defined in the Consumer Credit Protection Act (15 U.S.C. 1601 et seq.);

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzelment, or larceny;

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity;

STATEMENT OF THE CASE

Donald O. Daley (hereinafter referred to as "the debtor"), filed a voluntary Chapter 7 proceeding pursuant to 11 U.S.C. § 301 et seq., on February 11, 1983. Respondents are creditors who obtained a judgment in the United States District Court. for the District of Arizona, in CIV-80-857, August 20, 1982.

The Bankruptcy court's jurisdiction over the debtor was conferred by the Bankruptcy Reform Act of 1978, November 6, 1978, Pub.L. No. 95-598, § 241(a), 92 Stat. 2668 (then codified at 28 U.S.C.A. § 1471) [1]

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[1] That jurisdiction was declared unconstitutional in Northern Pipeline Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982), but the instant bankruptcy case was filed during this Court's brief stay of its judgment. Id. at 88. That jurisdictional hiatus was subsequently cured by the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub.L. 98-353, 98 Stat. 343 ("BAFRA"), and amendments to 28 U.S.C.A. § 1334 (Supp. 1985). Since BAFRA only became effective on July 10, 1984, federal district courts continued to exercise jurisdiction over bankruptcy matters between the expiration of this Court's stay and BAFRA's enactment pursuant to former 28 U.S.C. §§ 1334 and 1471(a) and (b). See, e.g., In re Kaiser, 722 F.2d 1574, 1578 (2d Cir. 1983); Matter of Braniff Airways, Inc., 700 F.2d 214 (5th Cir.), cert. denied sub nom. American Airlines, Inc. v. Braniff Airways, 461 U.S. 944 (1983).

In the instant litigation, the Respondent filed an adversary complaint seeking declaration that the debt evidenced by earlier judgment, was non-dischargeable on the basis of fraud, false representation, or willful destruction of property. The Respondents in said adversary complaint also sought punitive damages of at least $500,000.00 by reinserting the indentical ten counts grounded in fraud that had been dismissed with prejudice in CIV 80-857; and attorney fees of at least $25,000.00

The Petitioner then filed a Motion to Dismiss the adversary complaint on the basis that the judgment was founded upon a dischargeable debt; that the ten counts grounded in fraud, seeking new affirmative relief, had been dismissed with prejudice, and that this new relief was barred by the doctrine of res judicata. The Petitioner also requested that if successful on the Motion to Dismiss, he be awarded attorney fees and that Respondents were prohibited from objecting to such award by the doctrine of judicial estoppel.

In support of the Petitioner's claim, in his Motion to Dismiss, that the debt founded upon the judgment in CIV 80-857 was a dischargeable debt, the following materials were furnished to the Bankruptcy judge: Affidavit of Lester L. Penterman with index to Franks' deposition showing eighty-one exhibits (Walter L. Frank's deposition - nine pages of excerpts); (Joan Frank's deposition - nine pages of excerpts). Affidavit of Donald O. Daley with the First Amended Complaint, Stipulation to Dismiss certain counts and to enter final judgment on certain counts and Order, and the Judgment in CIV 80-857.

The Respondents, in their Response to the Motion to Dismiss, submitted the following materials to the Bankruptcy judge: Affidavit of Stephen R. Kaufman (with four pages of excerpts of Walter L. Frank's deposition and five pages of excerpts of Joan H. Frank's deposition attached), Affidavit of Joan H. Frank (with six pages of docket for CIV 80-857), plaintiff's first set of interrogatories to Daley; Answers to Request for Admissions by Daley; Deposition of Donald O.

Daley; note and newspaper article; accounting records of Donald O. Daley and Daley Enterprises; letter from First Pyramid Ins. Co., attached thereto.

In addition to the foregoing there were numerous memorandums filed by both Petitioner and Respondents as well as oral arguments to the Bankruptcy judge.

In support of the Petitioner's claim that the Respondents were barred from asserting the new claim for affirmative relief in the adversary proceeding before the Bankruptcy judge, the Petitioner submitted the Order dismissing the fraud counts with prejudice and argued that said new claims were barred by the doctrine of res judicata and the doctrine of judicial estoppel.

Respondents, in their appeal to the Court of Appeals for the Ninth Circuit, expressly waived their claim to punitive damages (App. D, D-2, footnote [3]).

Petitioner does not agree with the facts as set forth by the United States Court of Appeals for the Ninth Circuit in its opinion (App. D, D-2, D-3), wherein it states that the Motion to Dismiss was made on the grounds that the doctrine of judicial estoppel barred relitigation of the fraud claims. This doctrine was argued along with the doctrine of res judicata as it related to the affirmative claim for punitive damages in the sum of $500,000.00.

Petitioners agree that the factual background as set forth by the United States District Court for the District of Arizona is more representative of the facts. (App. C, C-2, C-3)

Both the Bankruptcy court opinion and the District Court opinion go to great lengths to distinguish the facts in the instant case, as it relates to the claim for punitive damages, from the facts considered by the Supreme Court in cases where the court considered whether res judicata precluded presenting evidence bearing upon the dischargeability of a debt, which in this case is an unliquidated claim for punitive damages. (App. A, A-3, A-4) (App. C, C-4, C-5, C-6)

Both the Bankruptcy Court and the District Court, after disposing of the request for punitive damages, reviewed the facts related to the judgment debt in CIV 80-857, and found the facts in favor of the Petitioner's claim; that this was a dischargeable debt, and that the Motion to Dismiss should be granted. (App. B, B-1, B-2) (App. C, C-6)

The Burden was upon the Respondent in the United States Court of Appeals, to show that the findings of fact in the Bankruptcy Court affirmed in the District Court, were clearly erroneous. No such finding exists in the opinion of the United States Court of Appeals for the Ninth Circuit.

REASONS FOR GRANTING THE WRIT

Introduction

This case seeks to determine the dischargeability of a debt reduced to judgment. The Respondent has claimed that the debt is non-dischargeable under the provisions of the Bankruptcy Code, 11 U.S.C. § 523 (a) (2,4,6). The Bankruptcy judge must consider all relevant evidence, including state court proceedings, offered by the parties and requested by the court; and on the basis of the evidence, determine dischargeability of judgment debt, which creditor contends falls within the category of non-dischargeable debts. See *In Re Houtman,* 568 F.2d 651 (1978), *Brown v. Felsen,* 442 U.S. 127 (1979), *Archibald v. Busby* Bkrtcy, 16 B.R. 234 (1981), *Clark's Delivery, Inc. v. Moultrie,* 51 B.R. 368 (Bankr. App 1985).

Where the Bankruptcy judge has considered the facts, all relevant evidence that is offered by the parties and requested by the court, and thereafter, makes findings of fact that the debt is dischargeable, the Court of Appeals reviews the Bankruptcy court's findings of fact under clearly erroneous standard. See *In re Comer,* 723, F.2d 737 (1984), *In re Houtman,* 568 F.2d 651 (1978)

The Bankruptcy court considered pleadings, memorandums, affidavits, and legal authorities cited by the parties and after oral argument, no request for findings of fact

having been requested, found the facts and law, in favor of the Petitioner. (App. B, B-1, B-2)

Consideration by the Bankruptcy judge of the Complaint, the jury instructions, the judgment and the debtor's testimony denying fraud, and refusing to consider the transcript, has been held to be a sufficient review of the facts, behind the judgment, to determine the dischargeability of the debt. See *In re Houtman*, 568 F.2d 651 (1978)

The rule that exceptions to dischargeability of a debt in bankruptcy are to be strictly construed has been recognized as the law for many years. See *In re Houtman*, 568 F.2d 651 (1978), *Gleason v. Thaw*, 236 U.S. 558, 35 S.Ct. 287, 59 L.Ed 717 (1915), *In re Rahm*, 641 F.2d 755 (1981)

I. The decision conflicts with federal law and applicable decisions of federal courts.

The United States Court of Appeals for the Ninth Circuit has held that the Bankruptcy court has the exclusive jurisdiction to determine dischargeability of a debt, and that the findings of fact of the Bankruptcy judge, which have been affirmed by the district court, cannot be set aside unless such findings are found to be clearly erroneous. See *In re Houtman*, 568 F.2d 651 (1978), *In re Comer*, 723 F.2d 737 (1984), *In re Dinoto* 46 B.R. 489 (Bankr. App. 1984)

In the Petitioner's case the Bankruptcy judge found the facts in favor of the Petitioner (App. B, B-1, B-2), which was affirmed by the District Court (App. C, C-5, C-6). The United States Court of Appeals for the Ninth Circuit, by its failure to find that the Bankruptcy judge's findings of fact in favor of the Petitioner to be clearly erroneous, has rendered a decision contrary to its prior decisions. See *In re Comer*, 723 F.2d 737 (1984), *In re Houtman*, 568 F.2d 651 (1978)

The United States Court of Appeals for the Ninth Circuit focused its attention to those portions of the opinions by the Bankruptcy court and the District court relating to the moot question where the Respondents made a claim for punitive damages, and how, that claim was distinguished from the

principals set out in *Brown v. Felsen*, 442 U.S. 127 (1979) and thereupon, concluded that the ruling of the Bankruptcy court and the District Court were purely legal decisions. (App. D, D-8)

II. Are the parties to an adversary proceeding to determine dischargeability of a debt entitled to a trial de novo.

Where a judgment has been entered, the Bankruptcy court is required to consider relevant evidence, and cannot accept the judgment from another court as having a preclusive effect upon the dischargeability of a debt. See *Brown v. Felsen*, 442 U.S. 127 (1979)

At issue in the instant case is whether the parties are entitled to a trial de novo to determine the dischargeability of a debt. The Petitioner contends that where sufficient facts are presented to allow the Bankruptcy court to consider all relevant evidence offered by the parties, or requested by the court, a trial de novo is not required. See *In re Houtman*, 568 F.2d 651 (1978), *Carey Lumber Co. v. Bell*, 615 F.2d 370 (1980), *In re Farley*, Bkrtcy., 15 B.R. 11 (1981), *In re Mastercraft Record Plating, Inc.*, 39 B.R. 654 (83 CIV 6405 R.L.C.)

Nowhere in the opinions of the bankruptcy court, or the District court did the judge indicate that his decision was based upon the belief that he was bound by the facts set forth in the judgment rendered in CIV 80-857. (App. A) (App. B) (App. C)

III. Were sufficient facts presented to the Bankruptcy Judge to sustain the judgment dismissing the Respondent's Complaint.

In the instant case the Bankruptcy judge, has not given the judgment a preclusive effect, but, has gone behind the judgment; and has received as part of the record, affidavits from counsel and parties who attached thereto the following items found in the record in CIV 80-857: Twenty seven pages of excerpts from the depositions of the Respondents, along with the index showing eighty-one exhibits, the entire

deposition of the Petitioner, the first amended Complaint, the Stipulation to Dismiss certain counts and to enter final judgment on certain counts and Order, the Judgment, the first set of interrogatories to Petitioner, accounting records of Petitioner and Daley Enterprises, as well as memorandums submitted by Petitioner and Respondent, and finally, oral arguments. The Bankruptcy judge considered these items not once, but on two occasions. (App. A, A-2) (App. C, C-3)

The facts considered by the Bankruptcy judge and District court judge exceed the material required to determine the dischargeability of a debt. See *In re Houtman*, 568 F.2d 651 (1978), *Carey Lumber Co. v. Bell*, 615 F.2d 370 (1980), *In re Farley*, Bkrtcy., 15 B.R. 11 (1981), *In re Mastercraft Record Plating, Inc.*, 39 B.R. 654 (83 CIV 6405 R.L.C.)

IV. Were the findings of fact by the Bankruptcy court affirmed by the District court, clearly erroneous.

On the basis of having considered pleadings, memorandums, affidavits with attachments and legal authorities cited, and oral argument, the Bankruptcy court found the facts and law submitted, in favor of the Petitioner (App. B, B-1 B-2). No request for findings of fact and conclusions of law was filed or requested by either party. (App. B, B-2)

The District Court specifically found that the Bankruptcy court had considered the relevant evidence not once, but twice, and affirmed its decision. (App. C, C-3, C-5, C-6)

The United States Court of Appeals for the Ninth Circuit has heretofore acknowledged that the Bankruptcy court has the exclusive jurisdiction to determine dischargeability of a debt, and that where the Bankruptcy court finds the debt dischargeable, and those findings are affirmed by the District court, they cannot be set aside unless such findings are found to be clearly erroneous. In the instant case there is no finding that they were clearly erroneous. (App. D) The Ninth Circuit Court states that the Bankruptcy court and District court relied solely on the stipulated dismissal with

prejudice, and throughout the decision, are responding to those portions of the Bankruptcy court and District court opinions related to the new claim for punitive damages, which became moot when the respondents waived their claim for $500,000.00 punitive damages which had been the subject of an extensive legal decision by both the Bankruptcy judge and District Cour judge.

CONCLUSION

Bankruptcy policy provides that the Petitioner be given a fresh start, and requires that bankruptcy courts are inherently courts of equity, *Katchen v. Landy*, 382 U.S. 323 (1966); and exceptions to dischargeability of a debt in bankruptcy, are to be strictly construed. *In re Houtman*, 586 F.2d 651 (1978), *In re Rahn*, 641 F.2d 755 (1981)

Where the bankruptcy court has found the facts in favor of the Petitioner, which has been affirmed by the District Court, the United States Court of Appeals cannot set aside those findings of fact unless they are found to be clearly erroneous. *In re Comer*, 723 F.2d 737 (1984), *In re Houtman*, 568 F.2d 651 (1978) The Supreme Court and the federal courts have held that the bankruptcy court has the exclusive jurisdiction to determine dischargeability of a debt without requiring a trial de novo. *In re Houtman*, 568 F.2d 651 (1978), *Carey Lumber Co. v. Bell*, 615 F.2d 370 (1980), *In re Mastercraft Record Plating, Inc.*, Bkrtcy., 39 B.R. 654 (83 CIV 6405 R.L.C.), *Brown v. Felsen*, 442 U.S. 127 (1979)

Lower federal courts should fully understand and apply those standards enunciated by the Supreme Court, the federal courts, and the intent of Congress, in granting the bankruptcy courts their jurisdiction. A decision by this Court is of paramount importance to the administration of bankruptcy law throughout the United States, and will further define and give guidance upon recurring dischargeability issues contained within the scope of § 523 of the Bankruptcy Code.

It is therefore, respectfully urged that this Court issue a writ of certiorari to the United States Court of Appeals for the Ninth Circuit to review its decision below, or if appropriate, summarily reverse it.

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APPENDICES

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Appendix A

IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF ARIZONA

In re: DONALD (DON) O. DALEY, Debtor. WALTER L. FRANK, individually and as Trustee of the Walter L. Frank, M.C., Ltd. Employees Pension Plan; and JOAN H. FRANK, his wife, Plaintiffs, vs. DONALD O. DALEY and DON DALEY ENTERPRISES, aka DALEY ENTERPRISES; PATRICIA L. DALEY, his wife, only as to her marital community with DONALD O. DALEY, Defendants.	NO. B-83-394 PHX-RGM ADVERSARY NO. 83-1036-RGM OPINION AND ORDER RE: PLAINTIFFS' OBJECTION TO FORM OF JUDGMENT

Filed February 23, 1984

Pending before the court is the plaintiffs' objection to the form of judgment lodged by the defendants as a response to this court's order of January 6, 1984. In that order, the court treated the defendants' motion to dismiss as a motion for summary judgment, granted the motion, and directed the parties to file a form of judgment for the court's approval.

The plaintiffs object that the form of judgment lodged by the defendants authorizes relief broader than that which was encompassed in the court's ruling. The defendants argued in their motion to dismiss that this entire adversary proceeding is barred by res judicata. At the hearing on the motion to

dismiss, however, defendants' counsel made statements that plaintiffs' counsel construed as limiting the motion to dismiss to those portions of the adversary complaint requesting punitive damages. Plaintiffs' counsel cited portions of the transcript of that hearing which, they say, both support their conclusion and bind the defendants.

Defendants' counsel argued that the remarks cited were taken out of context. He first noted that he and plaintiffs' counsel had earlier argued before this court a similar motion to dismiss in a related adversary proceeding. He then contended that the plaintiffs were attempting to attribute his statements about that case, *Bone v. Daley*, No. B-83-394/83-1037, to the motion he later argued in this case. He cited extensively from the transcript to support his claims.

The court is of the opinion that the defendants' counsel did not intentionally limit the scope of his motion to dismiss. The court further finds that there was no agreement approximating a binding stipulation among the parties. Thus, the defendants are not precluded from arguing this adversary proceeding should be dismissed in its entirety.

The court initiated the hearing on the plaintiffs' objection by stating that, if defendants' counsel had misspoken himself or if he were merely misunderstood, the court would reconsider the defendants' motion to dismiss on the merits. The court has done this, and it is still persuaded that the motion should be granted.

The plaintiffs sued the defendants in U.S. District Court, seeking recovery primarily on the bases of fraud and breach of contract. During that suit, the plaintiffs decided to pursue only their breach of contract claims, and they stipulated to a dismissal of their fraud claims *with prejudice*. Judgment was entered on those claims, and no appeal from that judgment was taken. Judgment was also entered in the plaintiffs' favor on at least eight breach of contract claims.

In the above-captioned adversary complaint, the plaintiffs have realleged their dismissed fraud claims almost verbatim.

They assert that res judicata does not bar their claim of non-dischargeability, which is predicated upon the fraud they had alleged in district court. In support of their position, they cite *Brown v. Felsen*, 442 U.S. 127, 99 S.Ct. 2205, 60 L.Ed. 2d 767 (1979).

The court finds the facts in this case significantly distinguishable from those considered by the Supreme Court in *Brown v. Felsen*. As a result, the court finds that the holding in that case does not reach as far as the plaintiffs contend.

In *Brown v. Felsen*, the United States Supreme Court considered whether res judciata precluded a creditor from presenting evidcence bearing upon the dischargeability of a debt that arose out of the stipulated settlement of a state court suit. Neither the settlement nor the resulting judgment indicated that it was predicated upon a particular cause of action. 99 S.Ct. at 2208. Nevertheless, the petitioner wanted to prove that the debtor had committed "deceit, fraud, and malicious conversion," making the debt owed to him non-dischargeable in bankruptcy. *Id.* at 2212.

The Court chose to allow the creditor to present his evidence. It was concerned that a contrary decision would force creditors to try dischargeability issues "to the hilt in order to protect [themselves] against the mere possibility that a debor might take bankruptcy in the future." *Id.* at 2211. In addition, the court did not want to force state courts to decide dischargeability issues. The Court noted that some state courts had indicated a reluctance to consider such issues, and it emphasized that bankruptcy court is generally the proper forum for deciding questions of dischargeability. *Id.*

The Court did not go so far as to say that res judicata could never be used to bar a claim of non-dischargeability in bankruptcy; it merely stated that res judicata should be "[i]nvoked only after careful inquiry." *Id.* at 2210.

As did the petitioner in *Brown* v. *Felsen*, the plaintiffs in this case raised claims bearing upon dischargeability in a prior, non-bankruptcy proceeding. Unlike that petitioner, however, these plaintiffs specifically consented to the dis-

missal of those claims with prejudice. Nothing precluded the plaintiffs from seeking a dismissal without prejudice from the District Court. Fed.R.Civ.P. 41(a)(2). Under these circumstances, the plaintiffs' decision amounts to a waiver of their right to raise their fraud claims before this court. This ruling serves simply to bind the plaintiffs to the terms of their bargain, which declared with some specificity that the allegations of fraud could not be raised again in court.

Based upon the foregoing opinion,

IT IS ORDERED that the plaintiffs' objection to the form of judgment lodged by the defendants is hereby overruled. That judgment will be executed and filed simultaneously with this order.

DATED this 23rd day of February, 1984.

/s/ Robert G. Mooreman
Robert G. Mooreman
U. S. Bankruptcy Judge

Copies of the foregoing mailed this 23rd day of February, 1984, to:

Lester L. Penterman, Esq.
John W. Wall, Esq.
Jon N. Vogel, Esq.
James P. Dunlavey, Trustee

/s/ Rosie Davis
Deputy Clerk

Appendix B

IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF ARIZONA

In re DONALD (DON) O. DALEY, Debtor.	In Bankruptcy Proceedings Under Chapter 7
WALTER L. FRANK, individually and as Trustee of the Walter L. Frank, M.C., Ltd. Employees Pension Plan; and JOAN H. FRANK, his wife, Plaintiffs, vs. DONALD O. DALEY and DON DALEY ENTERPRISES, aka DALEY ENTERPRISES; PATRICIA L. DALEY, his wife, only as to her marital community with DONALD O. DALEY, Defendants.	No. B-83-0394-PHX Adversary No. 83-1036 JUDGMENT

Filed February 23, 1984

This matter having come on regularly before the court upon the defendant's Motion to Dismiss and the court being advised in the premises finds as follows:

That the plaintiffs filed their complaint herein objecting to the defendant's discharge dated June 10, 1983.

That the defendant filed his Motion to Dismiss herein dated August 5, 1983.

That the court has considered pleadings, memorandums, affidavits, and legal authorities cited by the parties, and after

oral argument, no request for findings of fact and conclusions of law having been filed or requested by either party,

That the court finds the facts and law submitted in favor of the defendant.

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that the plaintiffs' Complaint filed herein be and the same is hereby dismissed.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the clerk of this court enter this judgment forthwith as a Final Judgment, pursuant to Rule 54(B), *Federal Rules of Civil Procedure* and Bankruptcy Rule 7054, there being no just reason for delay

/s/ Robert G. Mooreman
ROBERT G. MOOREMAN,
Bankruptcy Judge

Lodged this 16th day of January, 1984.

Copy mailed this 16th day of January, 1984 to:

John W. Wall
RYLEY, CARLOCK & RALSTON
26th Floor, The Arizona Bank Building
101 North First Avenue
Phoenix, Arizona 85003

by /s/ Lester L. Penterman
LESTER L. PENTERMAN

Copies of the foregoing mailed this 23rd day of February, 1984, to:

Lester L. Penterman, Esq.
John W. Wall, Esq.
Jon N. Vogel, Esq.
James P. Dunlavey, Esq.

/s/ Rosie Davis
Deputy Clerk

Appendix C

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF ARIZONA

In re DONALD (DON) O. DALEY, Debtor.	
WALTER L. FRANK, individually and as Trustee of the Walter L. Frank, M.D., Ltd. Employees Pension Plan; and JOAN H. FRANK, his wife, Plaintiffs/ Appellants,	NO. CIV 84-426 PHX CLH NO. B-83-0394 PHX RGM Adversary No. 83-1036
v. DONALD O. DALEY and DON DALEY ENTERPRISES, aka DALEY ENTERPRISES; PATRICIA L. DALEY, his wife, only as to her marital community with DONALD O. DALEY, Defendants/ Appellees.	MEMORANDUM OPINION AND ORDER

Filed October 5, 1984

Plaintiffs, creditors of defendant, have sought review of the decision of the bankruptcy court granting summary judgment in favor of the debtor-defendant, Donald O. Daley, on the issue of dischargeability of certain obligations allegedly due plaintiffs. The decision of the bankruptcy court will be affirmed.

FACTUAL BACKGROUND AND STATEMENT OF THE CASE

In 1971 or 1972 Daley began acting as insurance agent for Dr. and Mrs. Walter L. Frank and for the Walter L. Frank, M.D., Ltd. Employees Pension Plan (collectively referred to as "the Franks"). The Franks are citizens of Illinois. In 1978 and 1980 Daley obtained "loans" of substantial sums from the Franks for investment in Arizona and California real estate transactions in which Daley purportedly was involved.

Daley also operated a fixed-base airplane service. In 1978, 1979 and 1980 the Franks entered into airplane leases and management agreements with Daley. As part of these contracts Daley was to negotiate rentals or subleases of the aircraft that the Franks leased or owned.

Due to failure to be repaid and failure to receive profits, the Franks filed a federal district court action against Daley in 1980. CIV 80-857 PHX VAC. The twenty-one count complaint was based primarily on breach of contract and fraud.

After receiving summary judgment on the breach of contract claims, the Franks agreed to dismissal with prejudice of all counts relating to fraud in order that judgment could be entered and execution of the judgment could proceed. Judgment was entered August 20, 1982, in the sum of $485,000 plus costs, interest and fees.

On February 10, 1983, Daley filed a voluntary Chapter 7 bankruptcy petition. In June, 1983, Mr. and Mrs. Frank individually and Mr. Frank as trustee of the Pension Plan filed a complaint in the Bankruptcy Court seeking to have Daley's obligations to them declared nondischargeable pursuant to Bankruptcy Code §523(a)(2), (4) and (6), and requesting punitive damages of not less than $500,000. The complaint prayed for the sum of $489,000, representing the district court judgment, plus all other sums alleged in the complaint. The complaint essentially reiterated the allegations of the fraud counts of the federal district court action.

11 U.S.C. §523 sets forth exceptions to discharge. The following exceptions to discharge were relied on by the Franks:

> any debt
>
> (2) for obtaining money . . . or . . . renewal . . . of credit, by
>
> (A) false pretenses, a false representation, or actual fraud . . . ;
>
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny,
>
> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity.

Daley filed a motion to dismiss the Franks' complaint contending that the judgment in the district court was res judicata on the fraud issues relied on for nondischargeability. Daley also argued the doctrine of judicial estoppel.

The motion to dismiss was heard on December 2, 1983. Bankruptcy Judge Robert G. Mooreman granted the defendant's motion to dismiss treating it as a motion for summary judgment, and directed the parties to submit a form of judgment. The Franks objected to Daley's form, contending that defendant's counsel had stipulated that the motion to dismiss was limited to the portions of the complaint requesting punitive damages.

On January 30, 1984, a hearing was held on the objection. At the outset of the hearing, Judge Mooreman said that if defendant's counsel had misspoken or if he had been misunderstood, Judge Mooreman would reconsider defendant's motion to dismiss on the merits.

On February 23, 1984, the Bankruptcy Judge signed Daley's form of judgment and issued an Opinion and Order regarding the Franks' objection. Judge Mooreman determined that defendant's counsel did not intentionally limit the scope of his motion to dismiss. The bankruptcy court further found "there was no agreement approximating a binding stipulation between the parties."

The Opinion states that Judge Mooreman reconsidered the motion to dismiss on the merits and remained persuaded that the motion to dismiss the complaint in its entirety should be granted. Judge Mooreman stated:

> (P)laintiffs specifically consented to the dismissal of (claims bearing upon dischargeability) with prejudice .... (P)laintiffs' decision amounts to a waiver of their right to raise their fraud claims before this court. This ruling serves simply to bind the plaintiffs to the terms of their bargain, which declared with some specificity that the allegations of fraud could not be raised again in court.

DISCUSSION

The Franks made five arguments to the Court:

1. Their complaint for nondischargeability is not barred by the doctrine of res judicata.
2. The doctrine of judicial estoppel does not bar their claim for nondischargeability.
3. They are entitled to pursue their punitive damages claim in the bankruptcy court.
4. The Daleys are bound by their stipulation to proceed in the bankruptcy court on the nondischargeability claim.
5. There are genuine issues of material fact as to whether the Franks were defrauded by Daley.
   a. Daley's reliance on the Fifth Amendment privilege against self incrimination raises an adverse inference.
   b. The existence of promissory notes does not affect the issue of nondischargeability.

Daley does not argue the doctrine of judicial estoppel to this Court. The remaining arguments are all related to the major issue raised: whether the Franks' complaint for nondischargeability is barred by the doctrine of res judicata.

Plaintiffs rely on *Brown v. Felsen*, 442 U.S. 127 (1979) to support their contention that res judicata should not be ap-

plied to preclude them from meeting the "defense of bankruptcy" defendant has now imposed between the Franks and the monies due them.

Judge Mooreman found the facts of this case "significantly distinguishable" from the facts of *Brown*. The Court agrees. In *Brown*, neither the stipulation nor judgment indicated the basis of the liability. 442 U.S. at 128. Here, the stipulation and judgment are clear, stating that the fraud claims have been dismissed with prejudice and that the judgment is grounded on the remaining counts of the complaint.

In *Brown*, the Court said that the state court should not decide issues bearing on dischargeability when those questions were not directly in issue and neither party has a full incentive to litigate them. 442 U.S. at 134. Here, fraud counts were directly in issue before Judge Cordova. The Franks had full incentive to litigate those issues, but chose not to in the interest of expediting entry of judgment based on the contract claims and proceeding with execution on the judgment.

In *Brown*, the Court pointed out that the petitioner was not asserting a new ground for recovery nor attacking the validity of the former judgment, but that he was attempting to meet the "new defense of bankruptcy which respondent has interposed between petitioner and the sum determined due him." 442 U.S. at 133. Here, in effect, the Franks are attacking the validity of the dismissal with prejudice of their fraud claims by asserting anew those claims.

The Ninth Circuit has stated, "Bankruptcy courts recognize and apply the basic principles of res judicata in determining the effect to be given in bankruptcy proceedings to judgments rendered in other forums." *In re Comer*, 723 F.2d 737, 739 (9th Cir. 1984) (cite omitted). The Court of Appeals went on to discuss the exception to this general rule which the Supreme Court had created in *Brown*. The court said that the main concern of *Brown* and the Ninth Circuit's prior opinion *In re Houtman*, 568 F.2d 651 (9th Cir. 1978), was the preservation of the bankruptcy court's exclusive ju-

risdiction to determine dischargeability. 723 F.2d at 740. Res judicata should not be applied to preclude the bankruptcy court from exercising this exclusive jurisdiction. *Id.* The question is whether the application of res judicata would "preclude the exercise of the bankruptcy court's exclusive jurisdiction to determine the nature of the subject debt for the purpose of dischargeability." Id.

In *Brown,* the Court said that the bankruptcy judge could consider evidence extrinsic to the judgment and record when determining the dischargeability of a debt previously reduced to judgment. 442 U.S. at 138-39. This was necessary because the judgment itself did not indicate the basis of liability. Therefore, the bankruptcy court needed to determine the nature of the obligation in order to perform its statutory duty to determine the dischargeability of the debt.

However, in this case, the basis of the liability was established by the stipulation of the parties and the judgment of the federal district court. The bankruptcy judge had no reason to look behind the judgment to determine the nature of the obligation. The debt was a product of the contract claims only. A bankruptcy court should not rely exclusively on a prior court's determination when finding a debt dischargeable. *In re Comer,* 723 F.2d at 740. However, in this case, before making its determination that defendant was entitled to summary judgment, the bankruptcy court considered, as required, all relevant evidence. *See In re Houtman,* 568 F.2d at 654.

Dismissal with prejudice "has the effect of a final adjudication on the merits. *Wainwright Securities Inc. v. Wall Street Transcript Corp.,* 80 F.R.D. 103, 105 (S.D.N.Y. 1978). "Under res judicata 'a final judgment on the merits bars further claims by parties or their privies based on the same cause of action.' " *Brown v. Felsen,* 442 U.S. at 131 *(quoting Montana v. United States,* 440 U.S. 147, 153 (1979)).

Plaintiffs chose dismissal with prejudice in order to expedite the entry of judgment and proceed with collection efforts. They were prompted, in part, to make this decision

because they were aware that Daley's assets were limited and subject to demands from others. In May, 1980, they had loaned Daley $65,000 to enable him to cover a check he had written a third party. It is arguable that the Franks could have contemplated the possibility that Daley would file a bankruptcy petition. Judge Mooreman's determination that plaintiffs are bound by the terms of their stipulation is correct.

In the federal district court action, the Franks had prayed for punitive damages as part of each count relating to fraud. As Plaintiff's fraud claims could not be raised anew in the bankruptcy court, the claim for punitive damages was also rightfully dismissed.

Plaintiffs contend that the motion to dismiss should have been limited to the issue of punitive damages. They maintain that defendant's counsel stipulated to that effect in open court and that he further acknowledged that the non-dischargeability claim would go forward.

Plaintiffs raised this argument to the bankruptcy court in their objection to defendant's form of judgment. Judge Mooreman heard argument on the objection and found that counsel's motion was not so limited. That finding was not clearly erroneous and will not be disturbed by this Court.

Plaintiff's final argument that genuine issues of material fact exist as to whether they were defrauded by Daley is irrelevant. This conclusion follows from the determination that the doctrine of res judicata precludes the Franks from bringing to the bankruptcy court the fraud claims they had previously stipulated would be dismissed with prejudice.

IT IS ORDERED affirming the decision of the Bankruptcy Court.

DATED this 4th day of October, 1984.

/s/ Charles L. Hardy
CHARLES L. HARDY
Judge of the United States
District Court

cc: all counsel of record

Appendix D

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re DONALD O. DALEY, Debtor.	
WALTER L. FRANK, individually and as Trustee of the Walter L. Frank, M.D., Ltd., Employees Pension Plan; and JOAN H. FRANK, his wife, Plaintiffs-Appellants, vs. DONALD O. DALEY and DON DALEY ENTERPRISES, aka DALEY ENTERPRISES; PATRICIA L. DALEY, his wife, only as to her marital community with DONALD O. DALEY, Defendants-Appellees,	C.A. No. 84-2639 D.C. No. CIV 84-426 PHX-CLH OPINION

Filed November 13, 1985
On Appeal From the United States District Court
for the District of Arizona
Charles L. Hardy, District Judge, Presiding
Argued and Submitted October 10, 1985
San Francisco, California

Before: REINHARDT, BEEZER and HALL, Circuit Judges.

BEEZER, Circuit Judge:

Creditors in a Chapter 7 bankruptcy proceeding appeal the judgment of the district court affirming the bankruptcy

court's dismissal of creditors' adversary claim of non-dischargeability. We reverse and remand.

I

In February of 1981, the appellants, Walter and Joan Frank, filed suit against Donald Daley in United States District Court for the District of Arizona.[1] The complaint alleged twenty-one counts of breach of contract and fraud. In August of 1982, the district court granted summary judgment in favor of the Franks on the breach of contract claims. The Franks were awarded $485,800, plus $28,925 in attorney's fees, $3,664 in costs, and prejudgment interest. A stipulated dismissal was entered with prejudice on the remaining claims, which dealt primarily with fraud.[2]

In February of 1983, Daley filed a voluntary petition in bankruptcy under Chapter 7. The Franks filed an adversary complaint against Daley and Daley's wife seeking a declaration that the debt evidenced by the earlier judgment was nondischargeable under Bankruptcy Code, 11 U.S.C. §523(a)(2), (4), and (6).[3]

The Daleys moved to dismiss the adversary complaint on the grounds that the doctrine of judicial estoppel barred relitigation of the fraud claims. The bankruptcy court rendered final judgment in favor of the Daleys.[4] The court held that the Franks' consent to a dismissal with prejudice amounted to a waiver of their right to raise the fraud claims in a bankruptcy proceeding. The court reasoned that the Franks

---

[1] The complaint named Daley, his wife, and several business enterprises and corporations.

[2] In addition to dismissing ten counts grounded in fraud, the court dismissed two quasi-contract claims and one claim for indemnity.

[3] The Franks also sought punitive damages, which they expressly waive on appeal.

[4] The district court treated the dismissal as one for summary judgment since affidavits and supporting materials were attached. Neither the bankruptcy court nor the district court made findings of fact regarding the substance of the Franks' complaint.

should be bound to the terms of their bargain, which declared with some specificity that the allegations of fraud could not be raised again in court.

The Franks appealed to the district court. On appeal, the Daleys abandoned their judicial estoppel argument and argued instead that the doctrine of res judicata barred the Franks' complaint for nondischargeability. The district court affirmed the bankruptcy court. The court held that the dismissal with prejudice of the fraud claims in the earlier action constituted a res judicata bar to assertion of allegations of fraud in a bankruptcy proceeding.

II

We have jurisdiction over this appeal of a final judgment of the district court. 28 U.S.C. §1292. The district court had jurisdiction pursuant to 28 U.S.C. §§1334, 1471(b) and Local Rule 55 of the United States District Court for the District of Arizona. *In re Thomas*, 765 F.2d 926, 928-30 (9th Cir. 1985).

III

A district court's dismissal on res judicata grounds is subject to *de novo* review. *Hirst v. State of California*, 770 F.2d 776, 777 (9th Cir. 1985); *In re Comer*, 723 F.2d 737, 739 (9th Cir. 1984). A district court's order for summary judgment is also reviewed *de novo*. *Bunyan v. Camacho*, 770 F.2d 773, 774 (9th Cir. 1985).

IV

A. *Res Judicata (Claim Preclusion)*

The Franks argue that the Supreme Court's decision in *Brown v. Felsen*, 442 U.S. 127 (1979) requires reversal of the bankruptcy and district courts.

Brown involved a guaranteed loan. 442 U.S. at 128. Debtor defaulted and the bank brought suit against creditor and debtor in state court. *Id.* Creditor filed a cross-claim against debtor alleging that debtor induced creditor to guarantee the loan by misrepresentations and nondisclosure of material facts. *Id.* The suit was settled by stipulation, which

provided that the bank should recover jointly and severally against creditor and debtor, and that creditor should have judgment against debtor. *Id.* Neither the stipulation nor the judgment indicated the legal theory on which debtor's liability to creditor was based. *Id.* Debtor subsequently filed a voluntary petition in bankruptcy seeking discharge of his indebtedness. *Id.* Creditor sought to establish that the debt was nondischargeable under sections 17(a)(2) and 17(a)(4) of the Bankruptcy Act. *Id.* at 129.[5] Creditor alleged that the guarantee debt was the product of fraud, deceit, and malicious conversion. *Id.* Debtor moved for summary judgment on the grounds that res judicata barred relitigation of the nature of defendant's debts to creditor. *Id.* The bankruptcy court granted the motion. *Id* at 130. The district court and the Tenth Circuit affirmed. *Id.* The Supreme Court reversed. *Id.* at 139.

The *Brown* Court rested its decision on a variety of factors that apply with equal vigor to the instant case. The Court noted that application of res judicata in the context of a dischargeability determination is quite unlike res judicata in its usual setting. A creditor in a dischargeability proceeding "readily concedes that the prior decree is binding. That is the cornerstone of his claim. He does not assert a new ground for recovery, nor does he attack the validity of the prior judgment. Rather, what he is attempting to meet here is the new defense of bankruptcy which [the debtor] has interposed between [the creditor] and the sum determined to be due him." 442 U.S. at 133. The Franks, similarly, seek only to realize the judgment obtained in the prior proceeding.

---

[5] Section 523 of the 1978 Bankruptcy Code is substantially similar to section 17 of the Bankruptcy Act. *Brown v. Felsen*, 442 U.S. 127, 129 n.1 (1979). "[N]o reason exists why the rationale of the *Brown* decision should not be utilized in dealing with cases under Section 23(a)(2), (4), and (6) of the 1978 Bankruptcy Reform Act." *In re Eskenazi*, 6 B.R. 366, 368 (9th Cir. BAP 1980); *accord In re Comer*, 723 F.2d 737, 739 (9th Cir. 1984).

The *Brown* Court found that application of res judicata in dischargeability proceedings would inspire needless litigation by forcing "an otherwise unwilling party to try §17 questions to the hilt in order to protect himself against the mere possibility that a debtor might take bankruptcy in the future." *Id.* at 135. In the instant case, the Franks obtained judgment without going to trial. Since the Franks received contractual relief by summary judgment, they had no incentive to continue the litigation. If the Franks has pursued their fraud claims solely to protect their judgment, all parties would have sustained additional litigation expense. The Bankruptcy Code's policy of preserving debtors' estates is not well served by a rule that encourages needless litigation.

The *Brown* Court also noted that giving finality to prior state court rulings on section 17 questions would undercut Congress' intention to commit section 17 issues to the jurisdiction of the bankruptcy court. *Id.*

The Daleys seek to distinguish *Brown* by pointing out that in *Brown* neither the stipulation nor the judgment stated the legal theory upon which the prior judgment was based. The Daleys argue that the dismissal of the fraud claims with prejudice identifies the claim that was decided in the earlier proceeding.

Although *Brown* is distinguishable as the Daleys claim, the distinction is legally irrelevant. The Court in *Brown* did not rely on the distinction. Other than in its recitation of the facts, the *Brown* Court did not refer to whether the legal theory in the earlier proceeding was identifiable. Moreover, the Court's opinion suggests that the Court contemplated a hypothetical situation in which the legal theory was known. In discussing the possibility that application of res judicata would encourage needless litigation, the Court stated that "absent a trial on the merits, there is no particular reason to favor extraneous facts thrown into a record for §17 purposes over facts adduced before the bankruptcy court." 442 U.S. at 135. The context of this statement indicates that the "facts thrown into [the] record" are those facts indicating the legal

theory upon which debtor's liability was grounded. The statement, therefore, implies that even when the legal theory is apparent from the record, res judicata should not apply. The Daleys' reliance on the distinction between *Brown* and the instant case is misplaced.

The Daleys argue that the Franks' agreement to dismissal with prejudice binds the Franks to the terms of their bargain. The Supreme Court in *Brown* rejected a similar argument:

> [Debtor] argues that [creditor] could have avoided such a result and preserved his dischargeability contentions for bankruptcy court review by bargaining for a stipulation that §17 issues were not resolved by the consent judgment. It makes little sense, however, to resolve a federal dischargeability question according to whether or not the parties in state court waived their right to engage in hypothetical litigation in an inappropriate forum.

Id,. at 137.[6] Since the alleged differences between *Brown* and the instant case are irrelevant, the Supreme Court's decision in *Brown* requires reversal of the decision below.

In *In re Gross*, 654 F.2d 602 (9th Cir. 1981), we rejected arguments similar to those raised by appellees in the instant case. In *Gross*, the debtor asserted that a prior state court judgment rendered on contract grounds precluded the creditor from raising the question of fraud in a dischargeability proceeding in bankruptcy court. *Id.* at 604. The debtor contended that the contract judgment evidenced a binding election of remedies. *Id.* We held that such as assertion was contrary to the Supreme Court's decision in *Brown* and therefore that the bankruptcy court properly examined evi-

---

[6] Although the court in *Brown* discussed the res judicata effect of a prior state court judgment in a federal bankruptcy dischargeability proceeding, *Brown* applies with equal force to prior judgments rendered by United States District Courts. *See, e.g., In re Eskenazi*, 6 B.R. 366, 368 (9th Cir. BAP 1980) (determining preclusive effect of prior decision of U.S. District Court).

dence beyond the state court record in determining that the debt was not dischargeable. *Id.*

As in the instant case, the theory of liability in *Gross* was known. The only difference between *Gross* and the instant case is that in *Gross*, there was no indication that the parties expressly stipulated to dismiss the fraud claims in the earlier proceedings. This distinction, however, is irrelevant. Simply put, "[t]he doctrine of res judicata provides that when a final judgment has been entered on the merits of a case, '[i]t is a finality as to the claim or demand in controversy, concluding parties and those in privity with them, not only as to every matter which was offered and received to sustain or defeat the claim or demand, but as to any other admissible matter which might have been offered for that purpose.' " *Nevada v. United States*, 463 U.S. 110, 129-30 (1983) (quoting *Cromwell v. County of Sac*, 94 U.S. 351, 352 (1877)).

B. *Collateral Estoppel (Issue Preclusion)*

The Daleys argue that the Franks may not relitigate issues already decided.

> The Restatement (Second) of Judgments provides:
>
> When an issue of fact or law is actually litigated and determined by a valid and final judgment, and the determination is essential to the judgment, the determination is conclusive in a subsequent action between the parties, whether on the same or different claim.

Restatement (Second) of Judgments §27 (1982).[7] Comment e to section 27 states that "[i]n the case of a judgment entered by confession, consent, or default, none of the issues is actually litigated." Restatement (Second) of Judgments §27, comment e (1982). Since the dismissal with prejudice was entered pursuant to a stipulation, the fraud claims were not

---

[7] In determining the preclusive effect of a prior U.S. District Court judgment in a subsequent district court action, we have applied section 27 of the Restatement (Second) of Judgments. *See, e.g., In re Duncan*, 713 F.2d 538, 541 (9th Cir. 1983).

actually litigated. Moreover, since the Franks obtained their prayer for relief in the summary judgment on the contract claims, the "determination" of the fraud claims was not necessary to the judgment. Therefore, collateral estoppel does not apply.

Even if collateral estoppel technically applied, the special rules that govern the application of collateral estoppel in determining dischargeability in bankruptcy preclude the use of collateral estoppel in the instant case. In *In re Houtman*, 568 F.2d 651 (9th Cir. 1978), we stated that

> [t]he 1970 Amendments to the Bankruptcy Act imposed upon the bankruptcy courts the exclusive jurisdiction to determine dischargeability. As we read those Amendments there is no room for the application of the technical doctrine of collateral estoppel in determining the nondischargeability of debts described in section 17(a)(2), (4), and (8) of the Bankruptcy Act. This does not mean that the documents which officially enshrine the state court proceedings may not be considered by the bankruptcy judges as establishing the nondischargeability of a debt. What is required is that the bankruptcy court consider all relevant evidence, including the state court proceedings, that is offered by the parties, or requested by the court, and on the basis of that evidence determine the nondischargeability of judgment debts which the creditors contend are described in section 17(a)(2), (4), and (8).

Id. at 653-54 (citations and notes omitted, emphasis added).

In the instant case, the Daleys contend that the bankruptcy court examined all of the relevant evidence. The bankruptcy court's written decision cannot be read so broadly. The bankruptcy and district courts rendered purely legal decisions based on their interpretations of *Brown*. The courts relied solely on the stipulated dismissal with prejudice in the prior district court proceedings. The documents before the bankruptcy court were inadequate to permit it to form

an independent judgment regarding dischargeability.[8] Summary judgment, therefore, was inappropriate.

Under §523 of the Bankruptcy Code, the bankruptcy court has the exclusive jurisdiction to determine dischargeability. *In re Comer,* 723 F.2d at 740; *In re Houtman,* 568 F.2d at 653. To make this determination, the court must consider all relevant evidence bearing on the nature of the debt. *See In re Comer,* 723 F.2d at 740. The Franks were entitled to pursue their claims of nondischargeability in bankruptcy court. On remand, the bankruptcy court is directed to consider all relevant evidence and to determine dischargeability on the merits.

REVERSED and REMANDED.

---

[8] The Daleys argue that the bankruptcy court examined the documents attached to the Daleys' motion to dismiss the adversary complaint and to the Franks' response to that motion. Appellees' Brief at 8. As discussed above, the court's opinion reflects no such examination. Moreover, the documents to which the Daleys refer are insufficient for a determination of dischargeability.

The documents attached to the motion to dismiss include an eight page excerpt of the deposition of Walter Frank and a nine page excerpt of the deposition of Joan Frank, taken during the pendency of the prior district court action. The context of the excerpted testimony is unclear. To the extent that the excerpted material can be understood, the material does nothing more than attempt to refute allegations of fraud. The excerpts are not conclusive and at most raise a question of fact regarding the existence of fraud on the part of Daley. The motion to dismiss also includes an index to Walter Frank's deposition, and a copy of the complaint, judgment, and stipulated dismissal in the prior action. None of these items are probative on the issue of dischargeability.

The documents attached to the Franks' opposition to the Daleys' motion to dismiss include excerpts from depositions of the Franks and of Don Daley. These excerpts tend to indicate Daley's culpability and the Franks' reliance on Daley. The opposition documents also include interrogatories served on Daley and transcripts of Daley's deposition. Daley refused to answer the majority of the questions probative of fraud on the ground that his answers might incriminate him.

Appendix E

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

In re DONALD O. DALEY, Debtor.	C.A. No. 84-2639
WALTER L. FRANK, individually and as Trustee of the Walter L. Frank, M.D., Ltd., Employees Pension Plan; and JOAN H. FRANK, his wife, Plaintiffs-Appellants, vs. DONALD O. DALEY and DON DALEY ENTERPRISES, aka DALEY ENTERPRISES; PATRICIA L. DALEY, his wife, only as to her marital community with DONALD O. DALEY, Defendants-Appellees,	D.C. No. CIV 84-426 PHX-CLH ORDER

Before: REINHARDT, BEEZER and HALL, Circuit Judges.

The appellees' motion for extension of time in which to file a petition for rehearing is GRANTED. The petition already received shall be filed. The panel has considered the petition for rehearing and it is DENIED.

Filed January 13, 1986

Supreme Court, U.S.
FILED
MAY 7 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-1679

In The
Supreme Court of the United States
October Term, 1985

DONALD O. DALEY,

Petitioner,

v.

WALTER L. FRANK, individually and as Trustee of the Walter L. Frank, M.D., Ltd. Employees Pension Plan, and JOAN FRANK,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

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No. 85-1679

In The
Supreme Court of the United States
October Term, 1985

DONALD O. DALEY,

Petitioner,

v.

WALTER L. FRANK, individually and as Trustee of the Walter L. Frank, M.D., Ltd. Employees Pension Plan, and JOAN FRANK,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION

Respondents respectfully request that this Court deny the petition for a writ of certiorari, seeking review of the Ninth Circuit's opinion in this case.

STATEMENT OF THE CASE

Respondents agree with the factual and procedural summary set forth in the Opinion of the United States Court of Appeals for the Ninth Circuit (Pet., App. D, at 2, 3). The Respondents, Walter and Joan Frank, in their personal capacities and Dr. Frank, as representative of the Walter L. Frank, M.D., Ltd. Employees Pension Plan (hereinafter collectively referred to as "the Franks") commenced suit against the Petitioner, his wife and several business enterprises and corporations in the United States District Court for the District of Arizona. The complaint contained twenty-one counts, grounded in alternative theories of fraud and breach of contract.

Prompted by the desire to obtain a judgment upon which they could levy, the Franks moved for summary judgment on the contract counts, and prevailed. On August 20, 1982, they were awarded a judgment, which included fees and costs, of $518,389.00. In order to achieve finality, the Franks stipulated that the remaining counts could be dismissed, with prejudice.

On February 11, 1983, Petitioner filed a voluntary Chapter 7 bankruptcy proceeding in the District of Arizona. The Franks commenced an adversary proceeding, seeking a declaration that the debt evidenced by their judgment was nondischargeable pursuant to 11 *U.S.C.* §§ 523(a)(2), (4), and (6).

Instead of filing an answer, Petitioner moved for dismissal or, alternatively, that summary judgment be entered pursuant to F.R.Civ.P. 12(b)(6). The bankruptcy court granted the motion to dismiss and ruled that the

dismissal with prejudice, in the pre-bankruptcy district court action, constituted a *res judicata* bar on the nondischargeability issues. The district court, on the same basis, affirmed. The United States Court of Appeals for the Ninth Circuit, relying on this Court's decision in *Brown v. Felsen,* 442 U.S. 127 (1979), reversed the lower courts and remanded the matter for trial.

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REASONS FOR DENYING THE WRIT

1. The Standard of Review Was Properly a De Novo Review, Not The "Clearly Erroneous" Standard.

Neither the bankruptcy court nor the district court granted Petitioner's Motion to Dismiss on any basis other than the legal principle that the Franks were barred, by the doctrine of *res judicata,* from raising fraud-related issues in the bankruptcy court. *See,* Pet., App. A at 2-4; C-7. Indeed, findings of fact were not made by the bankruptcy court, since sufficient fact issues were raised by the pleadings to require an evidentiary hearing, thereby precluding entry of summary judment. Pet., App. D-9, n.8.[1] Therefore, since no factual findings were made, nor

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[1]Moreover, as the district court stated in its opinion, "Plaintiff's final argument that general issues of material fact exist as to whether they were defrauded by Daley is irrelevant. This conclusion follows the determination that the doctrine of res judicata precludes the Franks from bringing to the bankruptcy court the fraud claims they had previously stipulated would be dismissed with prejudice." Pet., App. C-7.

indeed, could have been made under F.R.Civ.P 12(b)(6) on the state of the record,[2] the lower courts ruled on the issues presented solely as matters of law.

Thus, the "clearly erroneous" standard of Bankruptcy Rule 8013, and F.R.Civ.P. 52(a) is not applicable, since conclusions of law are subject to *de novo* review. *In re Bialac*, 712 F.2d 426 (9th Cir. 1983); *In re Missionary Baptist Foundation of America*, 712 F.2d 206 (5th Cir. 1983). The United States Court of Appeals for the Ninth Circuit applied the correct standard of review to the legal principle which had been decided by the lower courts.

2. This Court's Decision in Brown v. Felsen has Been Followed by Courts in Every Circuit, and Petitioner Has Cited No Authority to the Contrary.

The United States Supreme Court, in *Brown v. Felsen*, 442 U.S. 127 (1979) held that the principle of *res judicata* did not apply to preclude a bankruptcy court from deciding dischargeability issues. *Id.* at 138-139. That decision followed the 1970 amendments to the Bankruptcy Act, 11 *U.S.C.* § 35.[3] The Bankruptcy Act was amended to insure exclusive federal control in the bankruptcy courts over all actions which sought to determine the viability of a debt discharged in a bankruptcy proceed-

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[2]See, Pet., App. D-9, n.8.

[3]§ 523 of the present Bankruptcy Code, 11 *U.S.C.* § 523 (effective October 1, 1979) is the successor provision to 11 *U.S.C.* § 35 (referred to in the cases as § 17 of the Bankruptcy Act), and for all material purposes, the provisions are similar.

ing. Before the 1970 amendments, a bifurcated system had allowed state courts to rule upon the nondischargeability of particular obligations, a practice which had led to abuse by creditors. Claims which should have been justly barred by a bankruptcy discharge were nonetheless pursued in state courts, which courts lacked adequate knowledge of federal bankruptcy law, while debtors were misled into believing that the suits had been nullified by their bankruptcy discharge. *See* S.REP. No. 91-1173, 91st Cong., 2d Sess., 6, 9 (1970); H.R. REP. No. 91-1502, 91st Cong., 2d Sess., 8 (1970). *See also In re Fulwider*, 624 F.2d 908, 909-10 (9th Cir. 1980); *In re Eskenazi*, 6 B.R. 366, 368 (9th Cir. BAP 1980); 3 COLLIER ON BANKRUPTCY § 523.11 at 523-74 (15th ed. 1985); 1B J. MOORE'S FEDERAL PRACTICE ¶ 0.419 [3.-4] (2d ed. 1985).

Since *Brown v. Felsen*, federal courts in every circuit have followed its mandate.[4] *See e.g., In re Comer*, 723 F.2d 737 (9th Cir. 1984); *Lovell v. Mixon*, 719 F.2d 1373 (8th Cir. 1983); *Carey Lumber Co. v. Bell*, 615 F.2d 370, 377 (5th Cir. 1980) (adopting district court decision); *Matter of Ross*, 602 F.2d 604 (3rd Cir. 1979); *In re Helm*, 48 B.R. 215 (Bankr. W.D. Ky. 1985); *In re Marks*, 40 B.R. 614 (Bankr. D.S.C. 1984); *In re Drayer*, 29 B.R. 831, 833 (Bankr. D. Mass. 1983); *In re Gilbride*, 32 B.R. 75 (Bankr. S.D. Fla. 1983); *Matter of Life Science Church*, 34 B.R. 529 (Bankr. N.D. Ind. 1983); *In re Black*, 18 B.R. 534 (Bankr. D.N.M. 1982); *In re Greenblatt*, 8 B.R. 994, 996 (Bankr. E.D. N.Y. 1981).

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[4]Federal courts have recognized that while *res judicata* is not appropriate to bar bankruptcy court inquiry into nondischargeability issues, principles of collateral estoppel may be of assistance on certain underlying factual determinations. *See, e.g. Lovell v. Mixon*, 719 F.2d 1373 (8th Cir. 1983).

The United States Court of Appeals for the Ninth Circuit has not deviated from the clear precedent of *Brown v. Felsen,* nor has it rendered a decision in conflict with another federal court of appeals on the same matter. Instead, it has reaffirmed a fundamental principle of bankruptcy law, that debts created by tort or other wrongful conduct should be determined on the merits, by a court with exclusive jurisdiction over the issues.

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CONCLUSION

For the reasons set forth herein, it is respectfully urged that the petition for a writ of certiorari be denied.

Respectfully submitted,

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